No. 03-539

SUPREME COURT, U.S.
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In The

Supreme Court of the United States

WESTERN WIRELESS CORPORATION,

Petitioner,

v.

DEPARTMENT OF REVENUE,

Respondent.

On Petition For A Writ Of Certiorari To The Supreme Court Of South Dakota

RESPONDENT'S BRIEF IN OPPOSITION

LAWRENCE E. LONG*
SOUTH DAKOTA
ATTORNEY GENERAL
500 East Capitol Avenue
Pierre, SD 57501-5070
(605) 773-3215

**Counsel of Record*

JACK C. MAGEE
SOUTH DAKOTA DEPARTMENT
OF REVENUE & REGULATION
445 East Capitol Avenue
Pierre, SD 57501-3185
(605) 773-4701

Counsel for Respondent

COCKLE LAW BRIEF PRINTING CO. (800) 225-6964
OR CALL COLLECT (402) 342-2831

COUNTERSTATEMENT OF THE QUESTION PRESENTED

Should the Court grant certiorari to review whether a complementary use tax imposed upon and paid by the purchaser of services performed out-of-state for use within the taxing state is consistent with the Commerce Clause, U.S. Const. art. I, § 8, cl. 3?

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BRIEF IN OPPOSITION

Petitioner requests this Court to grant certiorari to review an unremarkable decision of the South Dakota Supreme Court. The decision held that a complementary use tax imposed on and paid by the purchaser of services used within South Dakota but performed out-of-state did not violate the Commerce Clause. The petition should be denied because the question of whether a compensatory use tax may be imposed on an in-state purchaser of services used within the taxing state but performed outside the taxing state is a question that the Court has already addressed and answered in the affirmative and is one that involves no conflict among the lower courts.

STATEMENT OF THE CASE

A. South Dakota's Tax System.

Gross receipts received for providing a service are subject to South Dakota's sales tax, unless otherwise exempt. SDCL 10-45-4. If the sales tax cannot be imposed upon the seller of the service, the purchaser of the service is required to pay a complementary use tax on the value of the service. SDCL 10-46-2.1. Because the use tax imposed by SDCL 10-46-2.1 is complementary to the sales tax, it is not due if sales tax is owed or paid by the seller of a service. SDCL 10-46-6. If another state imposes its sales or use tax on a service before the service is used in South Dakota, a credit is given and the user will not owe use tax to South Dakota. SDCL 10-46-6.1.

B. Factual Background.

The Petitioner, Western Wireless Corporation, is a cellular telephone company with its corporate headquarters located in Issaquah, Washington. Western provides cellular phone services to customers in South Dakota and several other rural western states.

Western's customers receive monthly billing statements for the cellular phone service. Western entered into a contract with Computer Services Corporation ("CSC"), a billing service provider located in Champaign, Illinois. The contract provided that CSC would manage the billing of Western's customers.

Western records its South Dakota customers' cellular phone activity and the length of each customer's call on "switches" located in Sioux Falls, South Dakota and Rapid City, South Dakota. A switch is a mainframe computer that links the wireless network to the local exchange network, directs network traffic, and records cellular call data. Western's employees remove the tapes from the switch and send them to CSC in Champaign, Illinois.

CSC employees take the tapes and the information contained on them and run them through the "call rating process". The call rating process stores each customer's recorded information on a computer. CSC manipulates the data using its own proprietary software so that an electronic bill is generated. CSC electronically sends the bill to Western's Revenue Assurance group in Issaquah, Washington. Western has the power to decide if the electronic bills should be approved or corrected.

After the electronic bills are approved by Western's Revenue Assurance group, the data is sent to CSC's

subcontractor, International Billing Services ("IBS"). IBS takes the data that is in the form of an electronic invoice and prints the bill on paper. A paper bill is mailed via the United States Postal Service to each of Western's customers including those in South Dakota. Western's South Dakota customers then pay their bills. Neither Western nor CSC paid sales tax to any state because neither considered the service to be taxable.

The Department commenced a sales and use tax audit on Western's books and records which resulted in an assessment requiring Western to pay use tax of $232,408.12 on the billing services provided by CSC. The assessment was calculated by taking the value of the service provided by CSC for a customer ($2.50), multiplying that number by the number of Western's customers in South Dakota, and then applying the use tax.

C. Procedural History.

Western filed an administrative appeal and argued that assessment was contrary to state law and in violation of the Commerce Clause. The assessment was affirmed and Western filed an appeal in the state circuit court.

The circuit court affirmed the administrative decision. In holding that the assessment did not violate the Commerce Clause, the circuit court concluded that the tax met the four-part test of *Complete Auto Transit, Inc. v. Brady*, 430 U.S. 274 (1977).

On further appeal, the South Dakota Supreme Court affirmed the circuit court decision. In its decision, the South Dakota Supreme Court also examined a Commerce Clause issue and a separate state law issue. Although two

Justices dissented from the majority opinion, the dissent focused solely on the majority's holding on the state law issue. In examining the Commerce Clause issue, the court applied the four-part test of *Complete Auto* and concluded that the tax met the requirements for a valid use tax.

First, the court determined that South Dakota has a substantial nexus with the billing services provided by CSC because

> Western provides cellular telephone service to its South Dakota subscribers. It owns communications equipment and conducts business in South Dakota. It employs personnel in South Dakota to install and maintain the equipment. Electronic statistics on subscriber usage are transferred from South Dakota, where it originates, to Western's billing service contractor who, in turn, arranges for the South Dakota customers to receive bills for their usage.

Cert. Pet. App. at 8a. Second, the Court, cited *Haliburton Oil Well Cementing Company v. Reilly*, 373 U.S. 70 (1963), and concluded that the use tax applied equally to in-state and out-of-state transactions because it applies to all services "purchased inside or outside this state when the primary benefit of the service is used or consumed in this state and, at the time of purchase, sales tax was not imposed." Cert. Pet. App. at 9a. Third, the court found that the "use tax is fairly related to state-provided services because Western has the right and benefit of selling its services to South Dakota residents." Cert. Pet. at 9a. Fourth, the court relied on *D.H. Holmes Co., Ltd. v. McNamara*, 486 U.S. 24 (1988), holding that "the use tax does not discriminate against interstate commerce because the tax compensates the state for sales tax imposed on

similar in-state transactions." Cert. Pet. App. at 9a. Finally, the court found that the use tax is fairly apportioned because the tax: (1) reflects the way that Western uses this service because Western receives the service in South Dakota when its South Dakota customers are billed for their cellular usage and the primary benefit of the service is used or consumed in South Dakota; (2) is imposed only on customers receiving service in South Dakota, so that if every other state operated in the same way and taxed the billing service attributable only to its customers, there would be no duplication; and (3) imposes no threat of multiple taxation because South Dakota provides a credit for tax paid in other states. Cert. Pet. App. at 9a-10a (citing *Goldberg v. Sweet*, 488 U.S. 252 (1989)).

REASONS FOR DENYING THE WRIT

Petitioners have failed to identify any grounds warranting a grant of certiorari. The imposition of state use tax on services is not part of an emerging new legislative trend and is not an issue involving lower court conflict. Indeed, Petitioner can cite to no case, either from this Court or any lower court, that conflicts with the South Dakota Supreme Court's decision or that would dictate a different set of rules for a run-of-the mill use tax on services, such as the one at issue in this case. To the contrary, this Court has recognized the validity and applicability of complementary state use taxes to services purchased out of state but used within the taxing state. *See, e.g., Oklahoma Tax Commission v. Jefferson Lines, Inc.*, 514 U.S. 175, 193-194 (1995). The South Dakota

Supreme Court merely applied, correctly, the well-established tests from this Court for determining whether a complementary state use tax is valid under the Commerce Clause. The petition for writ of certiorari should be denied.

ARGUMENTS

I. THIS CASE DOES NOT PRESENT A CONSTITUTIONAL ISSUE OF SIGNIFICANT PUBLIC IMPORTANCE OR AN ISSUE AS TO WHICH THE LOWER COURTS ARE IN CONFLICT.

The petition requests the Court to "grant certiorari in this case to clarify for all states how Commerce Clause limitations on state taxing power apply to the imposition of use tax on services" because there is a growing trend among the states of enacting use taxes on services creating an issue of significant public importance. Cert. Pet. at 7. The Petitioner's allegation of a "growing trend" is simply without merit.

A leading tax scholar recently commented upon the reluctance of states to enact use tax on services purchased from out-of-state providers:

> In fact, this question rarely has arisen, because states have not sought to exercise authority over taxable services purchased from out-of-state service providers to the same extent that they have exercised such authority over tangible personal property purchased from out-of-state sellers.

J. Hellerstein & W. Hellerstein, State Taxation ¶ 18.06[2] (3d ed. 2003).

The Petitioner also misread the Federation of Tax Administrators report. Cert. Pet. at 5. While this report does analyze state sales tax on services, it notes

> The 1996 update reveals that the rate of expansion of the sales tax base to include services has declined. As the improvement of the economy during the past several years has translated into more stable state budgets, state policymakers have been reluctant to impose tax increases or new types of taxes. Indeed, no state has undertaken a broad-based expansion of the sales tax to services since Massachusetts in 1990 and Florida in 1987 (both were subsequently repealed) [footnote omitted]. Also, fewer states enacted legislation expanding the sales tax base to selected services than in earlier years.

FTA Research Report No. 147, Sales Taxation of Services, 1996 Update at 1 (Apr. 1997). Petitioner's suggestion that this South Dakota case presents an issue of rising national importance is unfounded when considered in light of the very treatise Petitioner used as authority.

Even if there were an emerging trend among the states of imposing the type of tax at issue here, the petition would still fail to raise an issue appropriate for this Court's review. The Petitioner fails to cite any lower court decision, state or federal, which conflicts with the South Dakota Supreme Court decision. In fact, the Petitioner does not cite a single case from another jurisdiction that addresses a complementary state use tax. To the extent other states are adopting complementary use taxes on services, those individual state tax systems will be reviewed by the lower courts and the law governing this type of tax will be developed. It is premature and unnecessary for this Court to intervene before the lower courts have

had that opportunity. This Court does not traditionally grant certiorari based on the asserted need to halt purported legislative trends that are untested in the lower courts.

II. THE SOUTH DAKOTA SUPREME COURT'S DECISION CORRECTLY APPLIED THIS COURT'S DECISIONS ADDRESSING THE IMPOSITION OF STATE USE TAXES.

The constitutional issue raised in the petition is not novel or unique. The South Dakota court involved a simple and routine application of the Court's test for complementary use taxes imposed upon transactions in interstate commerce. It is a garden-variety case because it involves no new legal test or theory. In fact, the Petitioner fails to cite any decision from a lower court or this Court that contradicts the decision of the South Dakota Supreme Court.

Quoting from the tax scholar relied upon by the Petitioner regarding the exact issue raised in this case:

> There should be no serious constitutional question, however, about the authority of states to impose a tax on services performed in other states but used or consumed in the taxing state. The legal predicate for imposing a use tax on services is the same as that for imposing a use tax on tangible personal property. The state has ample authority to impose a tax on the use or consumption of both tangible personal property and services in a state. Although the notion of taxing the use of services purchased in other states may seem strange to the casual observer, it is no stranger in theory than the notion of

> taxing the use of tangible personal property purchased in other states.[1]

J. Hellerstein & W. Hellerstein, State Taxation ¶ 18.06[2] (3d ed. 2003).

This Court has acknowledged the validity of complementary use tax imposed on services purchased or performed outside the taxing state but used within the taxing state. *Jefferson Lines*, 514 U.S. at 193-194. The Court stated:

> Since a use tax, or some equivalent on the consumption of services, is generally levied to compensate the taxing State for its incapacity to reach the corresponding sale, it is commonly paired with a sales tax being applicable only when no sales tax has been paid or subject to a credit for any such tax paid. Since any use tax would have to comply with Commerce Clause requirements, the tax scheme could not apply differently to goods and services purchased out of state from those purchased domestically. Presumably, then, it would not apply when another State's sales tax had previously been paid, or would apply subject to credit for such payment. In either event, the Oklahoma ticket purchaser would be free from multiple taxation.

Id. (citations omitted).

The sole question remaining here, therefore, is the rudimentary question of whether the South Dakota

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[1] Following this discussion, the author provided a synopsis of the circuit court decision in this case.

Supreme Court correctly applied the four-part test of *Complete Auto Transit, Inc. v. Brady*, 430 U.S. 274 (1977) which requires that the tax: (A) is to be applied to a taxpayer with clear nexus in South Dakota and to a transaction with clear nexus to the taxpayer's South Dakota business operations; (B) is fairly apportioned; (C) may not discriminate against interstate commerce; and (D) is to be fairly related to the services provided by the state.

A. Both Western and the billing service have nexus with South Dakota.

The petition vaguely and incorrectly claims that the billing service provided to Western is not sufficiently connected to South Dakota to allow imposition of the use tax.[2] Cert. Pet. at 10, fn. 10, and 13, fn. 11. Nexus is the required connection between the state and the transaction, property, or person the state seeks to tax. *Quill Corporation v. North Dakota*, 504 U.S. 298, 299 (1992). There is a definite and clear connection between South Dakota and the billing service because the billing service is indispensable to Western's South Dakota operations. Western relies on the billing service to generate payment for the cellular phone service it provides. Without the billing service, the most important aspect of its operations, that of getting paid, could not be accomplished. As noted by the lower court, Western has " 'so mingled taxable business [its cellular telephone business] with that which it contends is

[2] The petition makes no claim that the state lacks sufficient nexus with Western.

not taxable' (the billing services necessary to operate its South Dakota business), that the Commerce Clause is not offended." Cert. Pet. App. at 31a (citing *Norton v. Department of Revenue*, 340 U.S. 534, 538 (1951)).

B. The use tax imposed is fairly apportioned.

Western claims that South Dakota's use tax on billing services performed out-of-state creates the impermissible threat of multiple taxation. Cert. Pet. at 10. The South Dakota Supreme Court correctly concluded that the use tax in this case was fairly apportioned.

Whether a tax is fairly apportioned depends on whether it is internally and externally consistent. *Goldberg*, 488 U.S. at 261 (citations omitted); *Jefferson Lines*, 514 U.S. at 185. "Internal consistency is preserved when the imposition of a tax identical to the one in question by every other State would add no burden to interstate commerce that intrastate commerce would not also bear." *Jefferson Lines*, 514 U.S. 185. The use tax is imposed upon the billing services used by Western in conjunction with the cell phone services it provides to South Dakota customers. The use tax is not imposed on billing services used by Western in conjunction with cellular phone services provided to customers located in other states. SDCL 10-45-12.3. If each state imposes use tax on the billing services used in conjunction with the cellular services provided in that same state, the service is taxed only once, and there is no multiple taxation. *Jefferson Lines*, 514 U.S. at 185 (holding that "[i]f every state were to impose a tax identical to Oklahoma's, that is a tax on ticket sales within the state for travel originating there, no sale would be subject to more than one State's tax"). Accordingly, the South

Dakota Supreme Court correctly concluded that South Dakota's imposition of use tax on billing services for cell phone services provided in this state is internally consistent.

External consistency requires that "the State has taxed only that portion of the revenues from the interstate activity which reasonably reflects the in-state component of the activity being taxed." *Goldberg*, 488 U.S. at 262. The South Dakota Supreme Court correctly concluded that the use tax assessed here "reasonably reflects the way Western uses this service" and held that the tax reaches only that portion of CSC's billing service that is used by Western in South Dakota and therefore satisfies the external consistency test. Cert. Pet. App. at 9a. The tax satisfies the external consistency test.

C. State use taxes imposed upon services performed outside of the taxing state do not discriminate against interstate commerce.

In order for a complementary state tax to be nondiscriminatory, it must meet the following three conditions: (1) the taxing state must identify the intrastate tax burden the state is attempting to compensate; (2) the tax on interstate commerce must approximate, though not exceed, the amount of tax on the intrastate commerce; and (3) the transactions subject to the interstate and intrastate taxes must be "substantially equivalent." *Fulton Corporation v. Faulkner*, 516 U.S. 325, 332-333 (1996).

Applying *Fulton* to the use tax here, SDCL 10-46-2.1 does not yield a Commerce Clause violation. First, the intrastate tax burden complemented by SDCL 10-46-2.1 is SDCL 10-45-4:

> SDCL 10-45-4. There is hereby imposed a tax at the same rate as that imposed upon sales of tangible personal property in this state upon the gross receipts of any person from the engaging or continuing in the practice of any business in which a service is rendered. Any service as defined by § 10-45-4.1 shall be taxable, unless the service is specifically exempt from the provisions of this chapter.

If CSC were a South Dakota billing service provider, it would be subject to the sales tax imposed by SDCL 10-45-4. SDCL 10-46-2.1 simply provides that in the event the sales tax does not apply to the seller, here CSC, then the buyer of the billing service must pay use tax.

Second, the use tax assessed to Western equals the amount of sales tax that would be due from CSC because if CSC were subject to SDCL 10-45-4, it would owe sales tax only on those billing services associated with Western's South Dakota customers. Billing services associated with Western's non-South Dakota customers would be exempt. SDCL 10-45-12.3. This statute reads as follows:

> SDCL 10-45-12.3. *The tax imposed by this chapter upon persons performing services does not apply to transactions if the use of the service occurs entirely outside the state.* In instances of services performed on tangible personal property, use of the service occurs in this state if repair, refurbishment, adjustment, calibration, cleaning, maintenance, or other services are performed on tangible personal property in this state.

(Emphasis added.) Under this statute, an attempt by South Dakota to impose a sales tax on CSC's billing services directed at Western's out-of-state customers would be invalid. The only part of CSC's service that would be

subject to sales tax would be that part which is directed at Western's South Dakota customers. Accordingly, the only portion of the billing service used by Western subject to the use tax is associated with its South Dakota customers. Application of either the sales tax or the use tax would result in exactly the same amount of tax here. Imposition of use tax against Western satisfies the second condition of the *Fulton* test.

The third prong of this test, the "substantial equivalence" condition, is met for sales and use taxes because "they are strict functional equivalents of one another." *Fulton*, 516 U.S. at 343 (citing Hellerstein, *Complementary Taxes as a Defense to Unconstitutional State Tax Discrimination*, 39 Tax Lawyer 405, 434, n. 197, 458 (1986)). Since SDCL 10-46-2.1 is a complementary use tax to the sales tax imposed by SDCL 10-45-4, the third *Fulton* condition is met.

It is clear that the use tax in question, SDCL 10-46-2.1, as applied to Western's use of billing services satisfies the constitutional requirements for a valid complementary tax. It complements the sales tax on services by ensuring that persons using services in South Dakota pay the same tax, whether the service is purchased from an in-state or out-of-state seller. The Court should conclude that the Commerce Clause is not violated by imposition of use tax on Western's use of the billing services.

D. The complementary use tax is fairly related to the services South Dakota provides to Western.

The petition alleges that South Dakota does not provide the necessary protection and benefits required to

justify imposition of the use tax. Cert. Pet. at 12. Western admits, however, that South Dakota provides necessary "protection and benefit" to justify imposition of sales tax on its cellular phone services. Cert. Pet. at 13. To reconcile these divergent positions, Western argues that "South Dakota . . . does not confer any protections or benefits to the activities of CSC in performing billing services for Western. . . . " *Id.* This argument fails as the focus here is not on CSC, but upon Western. Western is the taxpayer, not CSC.

This argument might have merit if South Dakota were attempting to impose a tax on CSC, the billing service provider. However, as this Court has stated, "[T]he Commerce Clause demands a fair relation between a tax and the benefits conferred upon *the taxpayer* by the state." *Jefferson Lines*, 514 U.S. at 199 (emphasis added). It would be illogical to require there to be a fair relation between the benefits and protections and the service provider, CSC.

South Dakota is not subjecting CSC to the tax and therefore is not required to provide it any benefits or protection. The focus must remain on Western and the admitted undisputed benefits and protection it receives from South Dakota in consideration for the use tax it has been assessed. By Western's own admission, the tax is fairly related to the benefits and protections it receives from South Dakota and there is no constitutional issue to review.

CONCLUSION

The Petition for a Writ of Certiorari should be denied.

Respectfully submitted,

LAWRENCE E. LONG*
SOUTH DAKOTA
ATTORNEY GENERAL
500 East Capitol Avenue
Pierre, SD 57501-5070
(605) 773-3215

*Counsel of Record

JACK C. MAGEE
SOUTH DAKOTA DEPARTMENT
OF REVENUE & REGULATION
445 East Capitol Avenue
Pierre, SD 57501-3185
(605) 773-4701

Counsel for Respondent